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CITY OF LOS ANGELES, CALIFORNIA
AUDIT OBSERVATIONS AND RECOMMENDATIONS
JUNE 30, 2009

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6/24/10



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January 29, 2010

*Honorable Members of the City Council
City of Los Angeles, California*

We have audited the financial statements of the governmental activities, the business-type activities, the discretely presented component units, each major fund, and the aggregate remaining fund information of the City of Los Angeles, California (City) as of and for the year ended June 30, 2009, which collectively comprise the City's basic financial statements and have issued our report thereon dated January 29, 2010, except for Note 5F as to which the date is February 17, 2010. Our report was modified to include a reference to other auditors.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America; standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*.

In planning and performing our audit, we considered the City's internal control over financial reporting as a basis for designing our auditing procedures for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the City's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the entity's internal control over financial reporting. We have issued our Independent Auditor's Report on Internal Control over Financial Reporting and Compliance and Other Matters, which is dated January 29, 2010; Independent Auditor's Report on Compliance with Requirements Applicable to each Major Federal Program and on Internal Control over Compliance, which is dated March 11, 2010; and Schedule of Findings and Questioned Costs, which is dated March 11, 2010. Disclosures in those reports and schedule should be considered in conjunction with this management letter.

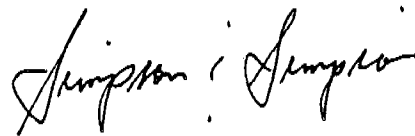
During our audit, we noted a deficiency in the internal control over financial reporting that we considered to be a significant deficiency that is reported in the "Report on Internal Control Over Financial Reporting and on Compliance and Other Matters Based on An Audit of The Financial Statements Performed in Accordance with *Government Auditing Standards*" dated January 29, 2010.

We also noted other matters involving the internal control structure that are presented herewith for your consideration. Our observations and recommendations have been discussed with appropriate members of management and are intended to improve the internal control structure or result in operating efficiencies. This letter does not affect the report dated January 29, 2010 on the financial statements of the City.

This report is intended solely for the information and use of the City Council, City Controller, management of the City, and its regulatory agencies, and is not intended to be and should not be used by anyone other than these specified parties.

Thank you for the opportunity to serve the City. We appreciate the courtesy and cooperation extended to us during our audit.

Very truly yours,

A handwritten signature in cursive script, appearing to read "Simpson & Simpson", written in dark ink.

Simpson & Simpson

CITY OF LOS ANGELES, CALIFORNIA
OBSERVATIONS AND RECOMMENDATIONS
JUNE 30, 2009

2009-1. Ensure Proper Access Controls for Accounts Receivables System (ARS)

Condition

During our review we noted two (2) individuals have WO (Write-off) and CR (Cash Receipts) access to the ARS. This could present a segregation of duties conflict as one person has both asset custody and transaction recording functions.

Recommendation

We recommend that either WO (Write-off) or CR (Cash Receipts) access be removed for the two individuals noted to ensure proper access controls for segregation of duties.

Management's Response

The affected departments have been requested to resolve the conflict, by transferring one of the functions from the employees affected to other staff so that one person does not have both asset custody and transaction recording functions. Controller Security Administration is working with the affected departments to ensure proper access controls.

Security Administration will also ensure that employees do not have access to both WO and CR in the future.

CITY OF LOS ANGELES, CALIFORNIA
OBSERVATIONS AND RECOMMENDATIONS
JUNE 30, 2009
(Continued)

2009-2. Strengthen System Security Controls for CashWiz

Condition

a. Windows Network Account Security for CashWiz

Stringent password security controls reduce the risk of unauthorized access by a system intruder running password cracking routines. However, the following was noted:

- (1) The invalid password attempts parameter for Windows Active Directory user accounts was set at five (5) instead of three (3) attempts. This condition increased a system intruder's ability to guess user account passwords.
- (2) The Minimum password age parameter was set to zero (0). As a result, users were able to repeatedly change their passwords until they could reuse their original password

Lack of stringent password security controls could increase the system's susceptibility to system intrusion.

b. Password Security Controls for CashWiz

CashWiz application passwords are transmitted in clear text upon data entry and prior to authentication. As a result, the password could potentially be intercepted and read by a system intruder during its transmission. Due to the sensitivity of the CashWiz application system (i.e., cash management activity), the application passwords should be encrypted during transmission.

Unauthorized access to the CashWiz application system may occur when system passwords can be intercepted and read.

c. CashWiz Server Room Environmental Controls

Although a water sprinkler system exists for the server room that houses the Office of the Treasurer's CashWiz application system, there currently is no fire extinguisher within the room. Unnecessary damage to the CashWiz financial data and software may occur when there is no chemical fire suppression mechanism readily available.

Recommendation

- a. We recommend that the Office of the Treasurer management reset the Windows account invalid password attempt parameter to 3 (three) attempts and set the minimum password age parameter to at least ten (10) passwords.

CITY OF LOS ANGELES, CALIFORNIA
OBSERVATIONS AND RECOMMENDATIONS
JUNE 30, 2009
(Continued)

2009-4. Strengthen System Controls for Payroll System Replacement (PAYSR)

Condition

a. Authorized Access Security Controls for PAYSR

Stringent authorization security controls reduce the risk of data manipulation by unauthorized personnel accessing the system. We noted that there were two (2) individuals out of five (5) users with Pay Rate table update access who were not Payroll Operations Supervisors or a Controller Payroll Analyst II.

b. Password Security Controls for PAYSR

During our testing of PAYSR user password parameters to ensure compliance with the security standards and policies, we noted that user password expiration period was set to zero (0).

Recommendation

- a. We recommend that Pay Rate table access should be restricted to authorized personnel, e.g., Payroll Operations Supervisors or Controller Payroll Analysts II.
- b. We recommend that user password parameter should be set to expire every sixty (60) days.

Management's Response

- a. Update access were revoked for two (2) individuals who were not Payroll Operations Supervisors.
- b. The PAYSR team opened a Work Order to impose password-changing rules that would require users to change their passwords every sixty (60) days.

CITY OF LOS ANGELES, CALIFORNIA
OBSERVATIONS AND RECOMMENDATIONS
JUNE 30, 2009
(Continued)

2009-5. Strengthen System Controls for Supply Management System (SMS) (Continued)

- c. We recommend that SMS password parameters adhere to the policy standard of user passwords expiring every sixty (60) days, minimum password length setting to be six (6) characters, failing login attempt setting to be three (3) attempts, and security control for reinstating access of lock-out user.

Management's Response

- a. In order to have the functionality to track the approver of vouchers, "Workflow" for the Vouchers has to be used. The SMS team will explore the best way to add audit functionality to record approver's User ID information at the time of approval for vouchers. A Service Request was opened for this effort and will be worked based on its priority.
- b. Inactivation of User ID was performed for the inappropriate users terminated or transferred.
- c. The SMS team opened a Service Request for the project of introducing standard user password security controls in SMS and will be worked and scheduled based on its priority.

CITY OF LOS ANGELES, CALIFORNIA
OBSERVATIONS AND RECOMMENDATIONS
JUNE 30, 2009
(Continued)

2009-6. Conduct Regular Meeting of the Investment Advisory Committee (IAC)

Condition

According to the Statement of Investment Policy Effective September 29, 2004 (Council File 04-1629), "The Investment Advisory Committee is tasked with the periodic review of investment performance and strategy." Also, "At least quarterly, the Investment Advisory Committee shall review all investment activity and its compliance to the corresponding governing articles and investment objectives." We noted that the IAC has not been meeting regularly for the past two years.

Pursuant to the City Charter Section 261(f), the Controller's Office performs an annual review of the condition of all City funds in the City Treasury and Treasurer's cash and investment activities compliance with the California Government Code. The annual review report is submitted to the Audits and Governmental Efficiency Committee and City Council for consideration. Also, an external investment advisor performs monthly comprehensive review and evaluation of the transactions, positions, and performance of the investment activities for compliance with the California Government Code and the City's investment policy and guidelines. However, these review and monitoring reports are not submitted to and reviewed by the IAC.

The Chair of the IAC submitted a recommendation for a reconstituted IAC. See detailed information in the Management's Response below. According to the City Council file no. 09-3050, the recommendation is under the City Council and its subcommittee's consideration and further discussions.

Recommendation

We recommend that the IAC resume meeting on a regular basis to review the investment performance and strategy and review the investment activity and compliance to the corresponding governing articles and investment objectives.

Management's Response

Management acknowledges that the Investment Advisory Committee (IAC) meetings were suspended. A November 2005 Management Audit concluded for the first time that IAC meetings were subject to the Brown Act and that, due to its composition, no more than three members could legally meet as a group (without a public posting in accordance with the Brown Act) on regular City activities. The Chair of the IAC submitted a recommendation for a reconstituted IAC, which is in the final stages of City Council adoption (Council File No. 09-3050). The Office of the Treasurer is currently seeking candidates for the IAC pending final City Council action. It is anticipated that the first candidate(s) will be submitted for City Council approval in early summer.

CITY OF LOS ANGELES, CALIFORNIA
OBSERVATIONS AND RECOMMENDATIONS
JUNE 30, 2009
(Continued)

2009-6. Conduct Regular Meeting of the Investment Advisory Committee (Continued)

Background

IAC was created by council action (Council File No. 86-1264) on July 22, 1987 after a public accounting firm performed an extensive review of the City's investment activities. Through this action, the IAC was "... composed of the City Treasurer, City Administrative Officer, Controller, Chief Legislative Analyst and an outside financial expert to periodically review investment performance and strategy with the Treasurer and his Investment Officer ..." Later, by council action, the committee was expanded to include the Office of Finance and the Office of the Mayor. One finding of a November 2005 Management Audit was that IAC meetings were subject to the Brown Act and that more than three members would be legally precluded from meeting as a group (without a public posting seventy two (72) hours in advance in accordance with the Brown Act) on regular City activities, i.e., budget, financings, audits, etc. As a result, no further meetings were scheduled. However, the members continued to receive the monthly and quarterly investment reports both from the Office of the Treasurer. In 2006, the Office of the Treasurer submitted a recommendation for a revised investment policy and a reconstituted IAC as recommended by the Management Audit. This report was never scheduled for committee. The Office of the Treasurer resubmitted another report in December 2009. In January 2010, the City Council is in the final stages of approving an action from that report which addressed another recommendation of the 2005 Management Audit. This recommendation specifically addressed the technical competency of the committee members. The new IAC will include the Chief Legislative Analyst and City Administrative Officer as ex officio members and a financial professional selected through a competitive Request for Proposal process. The remaining members will be approved by the City Council and the Mayor and consist of financial professionals who meet stringent technical and educational qualifications, including, but not limited to:

1. A valid baccalaureate, masters, or doctoral degree from an accredited college or university in any of the following major fields of study: business administration, public administration, economics, finance, accounting, or a related field, with a minimum of 16 college semester units, or their equivalent, in accounting, auditing, or finance.
2. Service in a senior financial management capacity in a county, city, or other public agency dealing with similar financial responsibilities for a continuous period of not less than three years, including, but not limited to, treasurer, tax collector, auditor, auditor-controller, or the chief deputy or an assistant in those offices.

CITY OF LOS ANGELES, CALIFORNIA
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JUNE 30, 2009
(Continued)

2009-6. Conduct Regular Meeting of the Investment Advisory Committee (Continued)

3. A valid certificate issued by the California Board of Accountancy pursuant to Chapter 1 (commencing with Section 5000) of Division 3 of the Business and Professions Code, showing that person to be, and a permit authorizing that person to practice as, a certified public accountant.
4. A valid charter issued by the Chartered Financial Analyst (CFA) Institute showing the person to be designated a CFA, with a minimum of 16 college semester units, or their equivalent, in accounting, auditing, or finance.
5. A valid certificate issued by the Association of Finance Professionals showing the person to be designated a Certified Treasury Professional or Certified Cash Manager, with a minimum of 16 college semester units, or their equivalent, in accounting, auditing, or finance.
6. The management of an investment portfolio with a minimum market value of \$1 billion.
7. Service as an investment advisor for a portfolio with assets exceeding \$5 billion.

IAC's new composition addresses the Brown Act considerations that existed with the prior committee's composition. Importantly, it will also provide the City with a resource of experts with investment knowledge that can appropriately and effectively advise the City Treasurer on issues impacting the City's investment program.

CITY OF LOS ANGELES, CALIFORNIA
OBSERVATIONS AND RECOMMENDATIONS
JUNE 30, 2009
(Continued)

2009-7. Strengthen Supervisory Review for Financial Reporting of False Alarm Fees Receivable

Condition

During our testing of false alarm fees receivable balance, we noted that the false alarm fees receivable and related uncollectible allowance in the amount of approximately \$2.3 million were written-off prior to formal approval by the Board of Review. The write-off request was submitted to the Board of Review for approval before June 30, 2009; however the request was approved in November 2009.

Recommendation

We recommend that receivable and related allowance be removed from accounting records after the approval by the Board of Review.

Management's Response

We concur with the recommendation and have established policy and procedure in the Alarm Section Manual for identifying and reporting allowance for doubtful accounts and accounts receivables. The procedure for identifying and reporting accounts receivables has been incorporated as part of the new false alarm management system (CryWolf) and will allow for validation of financial data submitted on the quarterly reports.

*CITY OF LOS ANGELES, CALIFORNIA
OBSERVATIONS AND RECOMMENDATIONS
JUNE 30, 2009
(Continued)*

2009-8. Analyze State Mandated Program Receivable and Related Allowance

Condition

The Los Angeles Police Department (LAPD) received two audit reports from the State Controller on the costs claimed for the State Mandated Peace Officers Procedural Bill of Rights Program for the period of July 1, 1994 through June 30, 2002 and July 1, 2003 through June 30, 2008. We noted that LAPD did not make any adjustments to its records to account for the audit results. As a result, adjustments have to be made to record an allowance for the uncollectible intergovernmental receivable.

According to the LAPD's officials, LAPD has been working with the State to clarify certain unallowable costs and the State has subsequently issued a draft revised audit report for the period of July 1, 1994 through June 30, 2002 in fiscal year 2009-10. However, it is critical that the results of the audit reports be analyzed and an allowance be recognized in the City's basic financial statements.

Recommendation

We recommend that the LAPD's staff analyze the audit results from the State and make necessary adjustments to its records.

Management's Response

Los Angeles Police Department staff will analyze the audit results from the State Controller and make the necessary adjustments to its records and reporting based on current information.

CITY OF LOS ANGELES, CALIFORNIA
OBSERVATIONS AND RECOMMENDATIONS
JUNE 30, 2009
(Continued)

2009-9. Improve Replacement Check Printing Process for Better Internal Control

Condition

The staff at the Check Reconciliation Section has ability to print checks for lost and previously issued checks. As a best practice, the check reconciliation function should be segregated from the check printing function.

Recommendation

We recommend that the City segregate the check printing function from the check reconciliation function to achieve the segregation of duties in the replacement check printing process. The replacement checks printing function may be performed by the staff that is not involved in the reconciliation function, such as the Demand Audit staff who normally prints checks.

Management's Response

Replacement checks for lost and previously issued vendor checks are printed by the Demand Audit staff while payroll replacement checks are printed by the Check Reconciliation Section. Due to resource issues, the Controller's Office will consider other options with regards to the printing of the payroll checks.

CITY OF LOS ANGELES, CALIFORNIA
OBSERVATIONS AND RECOMMENDATIONS
JUNE 30, 2009
(Continued)

2009-10. Ensure Sufficient Supporting Documentation for Salary and Wage Allocations in Cost Allocation Plan

Condition

According to Title 2 of the Code of Federal Regulations (2 CFR), Subtitle A, Chapter II, Part 225, "*Cost Principles for State, Local, and Indian Tribal Governments*" (formerly Office of Management and Budget Circular A-87 or OMB A-87), Appendix B, Sections 8.h.(4) and 8.h.(5), where employees work on multiple activities, a distribution of their salaries or wages will be supported by personnel activities reports or equivalent documentation which meets the standards listed below unless a statistical sampling system or other substitute system has been approved by the cognizant Federal Agency.

Personnel activities reports or equivalent documentation must meet the following standards:

- (a) They must reflect an after the fact distribution of the actual activities of each employee;
- (b) They must account for the total activities for which each employee is compensated;
- (c) They must be prepared at least monthly and must coincide with one or more pay period; and
- (d) They must be signed by the employee.
- (e) Budget estimates or other distribution percentages determined before the services are performed do not qualify as support for charges to Federal awards but may be used for interim accounting purposes, provided that:
 - (i) The governmental unit's system for establishing the estimates produces reasonable approximations of the activity actually performed;
 - (ii) At least quarterly, comparisons of actual costs to budgeted distributions based on the monthly activity reports are made. Costs charged to Federal awards to reflect adjustments made as a result of the activity actually performed may be recorded annually if the quarterly comparisons show the differences between budgeted and actual costs are less than ten percent; and
 - (iii) The budget estimates or other distribution percentages are revised at least quarterly, if necessary, to reflect changed circumstances.

During our testing of department cost allocation worksheets, we noted that the salaries and wages allocations for the City Attorney's Office and Mayor's Office were not supported by personnel activities reports or equivalent documentation as required by Federal Regulations. Instead, the allocations were supported by budgets or estimates, which may be disallowed by the cognizant Federal Agency during the negotiation process.

CITY OF LOS ANGELES, CALIFORNIA
OBSERVATIONS AND RECOMMENDATIONS
JUNE 30, 2009
(Continued)

2009-10. Ensure Sufficient Supporting Documentation for Salary and Wage Allocations in Cost Allocation Plan (Continued)

Recommendation

We recommend that the City Attorney's Office and Mayor's Office ensure that salary and wage allocations be supported by personnel activities reports or equivalent documentation which meets the Federal requirements.

Management's Response

The City Attorney's Office has developed a time study for a two-month period and will implement the time study for the next cost allocation plan.

The salary and wage allocations of the Mayor's Office were supported by estimates. The Mayor's Office has taken steps to analyze activities for cost centers and will implement the work order system with the new Financial Management System (FMS).

CITY OF LOS ANGELES, CALIFORNIA
OBSERVATIONS AND RECOMMENDATIONS
JUNE 30, 2009
(Continued)

2009-11. Ensure Consistent and Justified Composition of the Indirect Cost Centers/Pools

Condition

According to 2 CFR Part 225 (formerly OMB Circular A-87), Appendix A, Section F.1., "To facilitate equitable distribution of indirect expenses to the cost objectives served, it may be necessary to establish a number of pools of indirect costs within a governmental unit department or in other agencies providing services to a governmental unit department. Indirect cost pools should be distributed to benefitted cost objectives on bases that will produce an equitable result in consideration of relative benefits derived."

We noted inconsistency in the composition of the indirect cost centers/pools of the City Administrative Officer (CAO) and the Mayor's Office between CAP 31 and 32. In addition, the groupings of indirect cost items or work orders were not justified and supported by documentations or policy and procedures. After discussions with the staff at the CAO and Mayor's Office who prepared the worksheets, revisions were made to the department allocation worksheets to correct the allocation.

The staff at the CAP Section of the Controller's Office (CAP Section) and the auditors had to spend excessive amount of time to work with the above departments to correct the allocation worksheets to ensure compliance with the requirements as set forth in OMB Circular A-87.

Recommendation

We recommend that staff who prepares the department allocation worksheets for the first time coordinates with the Controller's CAP Section staff for training and/or special instruction for the preparation of the worksheets. We also recommend that the department staff documents and maintains supporting information for the preparation of department allocation worksheets.

Management's Response

From the Office of Mayor

The audit noted an inconsistency in the composition of the indirect cost centers/pools between CAP 31 & 32. The Mayor's Office in the past and for CAP 31 would require all staff to complete a questionnaire annually and each individual would identify the CAP category their work activities belonged to. For CAP 32, the Mayor's Office was notified that this was no longer accepted. An analysis of the functions and activities performed was completed on each of the cost centers.

CITY OF LOS ANGELES, CALIFORNIA
OBSERVATIONS AND RECOMMENDATIONS
JUNE 30, 2009
(Continued)

2009-11. Ensure Consistent and Justified Composition of the Indirect Cost Centers/Pools
(Continued)

The Mayor's Office has already taken steps to correct the findings. The Mayor's Office has analyzed the office activities for all the cost centers with the assistance of the Deputy Mayor's. Furthermore, with the incoming new FMS system the work order is required by the system as well and will be put into place.

From the Office of the City Administrative Officer (CAO):

The staff at the CAO will take necessary steps to document the procedures in preparing the allocation worksheets and maintaining proper supporting documents. The CAO will continue to work with the Controller's Office on the preparation of the allocation worksheets.

CITY OF LOS ANGELES, CALIFORNIA
OBSERVATIONS AND RECOMMENDATIONS
JUNE 30, 2009
(Continued)

2009-12. Use Consistent Source for Square Footage Occupied for Allocation of Building Depreciation in Central Service Plan

Condition

According to the City's Central Service Plan Narrative Descriptions of cost pools for building depreciation, the building depreciation amount is allocated to departments based on square footage occupied.

In allocating building depreciation amount, the CAP Section obtains information on square footage occupied by departments from the General Service Department (GSD). The CAP Section then verifies this information against the departments' records. In situation where there is a variance between the information provided by GSD and a department, the CAP Section applies the lower costs/square footage or other judgmental basis. As a result, building depreciation amount is not allocated in a consistent manner.

GSD's records on square footage occupied were not reconciled to the departments' records prior to the preparation of the Cost Allocation Plan. Building depreciation amount was not allocated in a consistent manner, which may result in questions on the allocation processes and method by the Federal negotiator.

Recommendation

We recommend that the City review the information for square footage occupied and consistently use appropriate information during the preparation of the City's cost allocation plan.

Management's Response

Due to constantly changing personnel requirements, building occupancy is always in a state of flux. CAP staff reviews square footage allocations every year and generally allocates the amount of square footage to departments based on square footage occupied as reported in the department worksheets. This may not always match with the Department of General Services data. In most cases, the difference between the department worksheet and the General Services spreadsheet is not significant.

In those instances where the difference is significant, CAP staff tries to resolve the issue and use the correct square footage. In cases where discrepancies remain, the policy is to use the higher square footage amount. This results in a lower cost in conformity with the accounting principle of conservatism.

CITY OF LOS ANGELES, CALIFORNIA
OBSERVATIONS AND RECOMMENDATIONS
JUNE 30, 2009
(Continued)

2009-13. Implement Supervisory Reviews on Supporting Worksheets for Cost Allocation Plan

Condition

The management of the City is responsible for establishing and maintaining effective internal control over financial reporting and compliance with requirements of laws, regulations, contracts, and grant agreements applicable to federal programs.

We noted numerous errors in the worksheets provided by the departments used in the preparation of CAP 32. The worksheets were not being reviewed for accuracy by a second reviewer. Errors and omissions may be undetected, which may result in disallowance by the Federal negotiator.

The following is a summary of the errors noted during our testing:

- Missing cost amounts on the worksheets provided by Public Works Bureau of Sanitation, the Office of the Treasurer, Community Development Department, and Department of Recreation and Parks
- Inputting errors on worksheets from the Office of the Controller, Public Works Bureau of Contract Administration, Emergency Management Department, and Los Angeles Convention Center
- Certain worksheets not updated for current year information
- Incorrect calculation formula or formula reference on various cost allocation statistic worksheets for Fringe Benefit Plan and Central Service Plan
- Costs information not updated on retirement and pension worksheets under Fringe Benefit Plan and building lease worksheet under Central Service Plan

Recommendation

We recommend that CAP worksheets be reviewed for errors and omissions during the preparation of the City's cost allocation plan.

Management's Response

We agree, however, given the large amount of data we collect, analyze, and allocate, the problems identified are minor and do not materially affect the CAP. The errors referred to by the auditors are immaterial and do not rise to the level of costs being materially misstated.

Due to staffing vacancies in departments and in the CAP Section, there is inadequate staff to permit a second review of many of the numerous worksheets and allocation statistics. We acknowledge this as an issue and will increase our review of future CAPs. However, as departments continue to lose their experienced staff, the CAP Section time will continue to be diverted to working with departments to correct errors and omissions.

CITY OF LOS ANGELES, CALIFORNIA
STATUS OF PRIOR YEARS' OBSERVATIONS AND RECOMMENDATIONS
JUNE 30, 2009

2008-1. Develop Written Policies and Procedures for the Calculation of Allowance for Uncollectibles for Business Taxes

Condition

During our testing of the allowance for uncollectibles for business taxes, we noted that the City did not have written policies and procedures to document the methodology for estimating the allowance for uncollectibles for business taxes. Also, the City did not maintain centralized and comprehensive data to support the calculation.

Recommendation

We recommend that the Office of Finance develop written policies and procedures to document the methodology and maintain supporting data and detail worksheets for the calculation of allowance for uncollectibles for business taxes. The Office of Finance should also ensure that the written policies and procedures are consistently applied and the calculation worksheets be reviewed.

Management's Response

In the estimation of the allowance for uncollectibles for business taxes, we factored a "valuation allowance" in accordance with generally accepted accounting principles to account for the estimated tax assessments and more accurately reflect the true value of the taxes receivable. We agree that written policies and procedures should be developed and consistently applied, and will provide supporting data for the calculation of the allowance for uncollectible business taxes.

Current Year Status

The Office of Finance has developed written policies and procedures to document the methodology and maintained supporting data for estimating the allowance for uncollectibles for business taxes. The Office of Finance will continue its effort to review the factors used to estimate the allowance for uncollectibles and retain supporting documents for developing the factors.

CITY OF LOS ANGELES, CALIFORNIA
STATUS OF PRIOR YEARS' OBSERVATIONS AND RECOMMENDATIONS
JUNE 30, 2009
(Continued)

2008-2. Improve Loan Recording Process at the Housing Department

Condition

We noted that a loan disbursed at the end of fiscal year 2007-08 was not recorded timely by the Housing Department (LAHD) into the Loan Tracking System (LTS). The loan was entered into the LTS in February 2009. Since this is a forgivable loan, the net realizable loan receivable amount is not considered material to the government-wide financial statements.

According to the management of the LAHD, the reason for the above condition was due to the delay in reviewing and approving the loan package and eventually assigning a loan tracking number to the loan.

Recommendation

We recommend that the LAHD streamline the loan recording process and improve communication and document flow to ensure that a new loan will be entered into the system in a timely manner.

Management's Response

When the loan servicing system was designed, it was intended to service real estate secured loans, which represent virtually all of the department's portfolio. However, the loan discussed above is an unsecured forgivable loan that finances a loss reserve for the New Generation Fund, which is the first of this type of loan for the Department. For this reason, set up for this unsecured loan presented unforeseen problems as it could not follow the normal process for setting up a real estate loan when the system was designed.

Due to timing issues, the loan for the New Generation Fund was disbursed first and was not set up until it was determined whether and how this unsecured loan should be set up in the system. This is not the Department's operating procedure for real estate loans, which requires that loans must be first set up in the servicing system prior to any disbursements being made. For all future project disbursements, accounting will confirm with program management to determine if they are loan related, and if they are, ensure that the related loan is set up in the system prior to releasing disbursements.

Current Year Status

No other loans with the condition above were noted. The observation is no longer applicable.

CITY OF LOS ANGELES, CALIFORNIA
STATUS OF PRIOR YEARS' OBSERVATIONS AND RECOMMENDATIONS
JUNE 30, 2009
(Continued)

2008-3. Implement Procedures to Resolve the Difference in Investment Balance between Cash Control and SYMPRO

Condition

There is a difference in the General Pool investment balance in the amount of \$460,821 between Cash Control and SYMPRO, the Office of the Treasurer's investment management system, as of June 30, 2008. The Office of the Treasurer identified that the difference was caused by the following two reasons:

- (1) SYMPRO's inability to accommodate the in-house transfer of investments from the reserve (long-term) portfolio to the core (short-term) portfolio. As a result, the in-house transfer transactions were recorded as a sale entry for removing (transferring out) the investment from the reserve portfolio and a purchase entry for adding (transferring in) the investment to the core portfolio in SYMPRO. SYMPRO automatically recognized accrued purchase interest for the investment purchase entry, which was not applicable for the in-house transfer. As a result, the investment balance per SYMPRO is overstated by \$457,824.
- (2) Errors in Cash Receipt (CR) entries for investment income receipts from mortgage backed securities (MBS) and collateralized mortgage obligations (CMO). SYMPRO is designed to manage fixed-income investments which normally pay only interest income to investors semi-annually based on the quoted rate on the face value until maturity. However, MBS and CMO normally pay both principal and interest monthly to their investors. Due to the difference in investment payment structures, SYMPRO was not able to provide accurate information for CR entries. In addition, there were errors in CR entries for investments sold prior to the first interest payment date. As a result, the investment balance per Cash Control is overstated by \$918,645.

Recommendation

We recommend that the City Treasury Office resolve the difference between Cash Control and SYMPRO and implement additional control procedures to properly record and report transactions for in-house investment transfers and MBS/CMO investments.

CITY OF LOS ANGELES, CALIFORNIA
STATUS OF PRIOR YEARS' OBSERVATIONS AND RECOMMENDATIONS
JUNE 30, 2009
(Continued)

2008-3. Implement Procedures to Resolve the Difference in Investment Balance between Cash Control and SYMPRO (Continued)

Management's Response

The Office of the Treasurer has taken actions to implement the recommendation. The difference between SYMPRO and Cash Control in the amount of \$457,824 was resolved when these transferred investments matured in the first quarter of 2009. In addition, correction entries for the errors noted in the CR described in item (2) were recorded in cash control and FMIS. The Office of the Treasurer has also requested a budget appropriation so that the present Cash Control spreadsheet can be replaced with a more efficient system.

Current Year Status

(1) All of the correcting and adjusting entries for the overstatement of \$457,824 were made in December 2008.

(2) All of the correcting and adjusting entries for the overstatement of \$918,645 were made in December 2008.

For transactions occurring after the audit, as a solution to SYMPRO's limitation, manual adjustments were processed prior to preparing the Cash Receipts (CR). Hence, only the correct amounts are entered in FMIS. The company that supports SYMPRO has informed the Office of the Treasurer that this issue will be resolved with its new version. The transition to the new version will begin in January 2010.

The observation is no longer applicable.

CITY OF LOS ANGELES, CALIFORNIA
STATUS OF PRIOR YEARS' OBSERVATIONS AND RECOMMENDATIONS
JUNE 30, 2009
(Continued)

2008-4. Use Appropriate Worksheet to Properly Recognize and Report State Mandated Program Receivable

Condition

The LAPD uses a summary worksheet to track claim billings and payments received for a State Mandated program. The outstanding amount shown on the worksheet was used for the recording of the State Mandated program receivables and reported as part of the intergovernmental receivable in the City's annual financial statements.

Based on our testing of the summary worksheet, we noted that the outstanding amount was understated by approximately \$1.6 million due to the inclusion of estimated revenue receipts in the summary worksheet. As a result, the intergovernmental receivable was understated. The LAPD indicated that the worksheet was originally designed for management and budgeting purposes and was subsequently used for the financial accounting and reporting purposes.

Recommendation

We recommend that the LAPD design a worksheet to properly recognize claim billings, payments received, and outstanding amount of the State Mandated program to meet the requirement for financial accounting and reporting in accordance with generally accepted accounting principles.

Management's Response

LAPD will redesign the worksheet to properly recognize the claim billings, payments received, and outstanding amount of the State Mandated program.

Current Year Status

During the fiscal year 2008-09 audit, LAPD used actual receipt in the summary worksheet for analyzing claim billings, payment received, and outstanding amount of the State Mandated program. The observation is no longer applicable.

CITY OF LOS ANGELES, CALIFORNIA
STATUS OF PRIOR YEARS' OBSERVATIONS AND RECOMMENDATIONS
JUNE 30, 2009
(Continued)

2007-3. Develop Written Policies and Procedures for Billing, Processing, and Reporting of False Alarm Fees

Condition

Based on our tests, the false alarm fees receivable balance of \$13.5 million at June 30, 2007 was overstated by \$2.8 million. We noted that there are no formal policies and procedures for recording false alarm fees receivable. The False Alarm Section (FAS) of the Los Angeles Police Department (LAPD) utilizes the Office of Finance's financial management system, LATAx, for billing and collection of false alarm fees. LATAx is maintained by Information Technology Agency (ITA). At the end of the fiscal year, LAPD's Fiscal Operation Division (FOD) reports the false alarm fees receivable and allowance for uncollectibles to the Controller's Office which are based on a summary report generated from LATAx. Our review of the summary report indicated that the parameters (i.e., aging of receivables) were not defined and the report was not reviewed for accuracy.

Recommendation

We recommend that LAPD develop written policies and procedures for processing, billing, and reporting of false alarm fees. Also, the policies and procedures should include supervisory review and approval.

Management's Response

LAPD has taken actions to improve the policies and procedures for billing, processing, and reporting of false alarm fees. LAPD has developed a manual which outlines the policies and procedures for processing, billing, and reporting of false alarm fees. Currently, LAPD is working with the ITA and the Office of Finance to generate the necessary reports for financial reporting. In addition, LAPD is in the final process of recommending the procurement of a new false alarm and permit management system. The current manual will be updated as the new system is developed and implemented.

Current Year Status

LAPD entered an agreement with a professional service company for a new alarm and permit management system in August 2008. The new system went live in June 2009 and provides a variety of services, including permit tracking, status changes, false alarm correspondence, billing, and accounts receivable management. Effective in July 2009, LAPD also implemented a procedures manual which documents policies and procedures for tracking false alarms; processing billing, payments, and delinquent accounts; and financial reporting. LAPD continues to update the manual as new procedures are identified.

The observation is no longer applicable.

CITY OF LOS ANGELES, CALIFORNIA
STATUS OF PRIOR YEARS' OBSERVATIONS AND RECOMMENDATIONS
JUNE 30, 2009
(Continued)

2003-3. Timely Reporting by the Enterprise Departments, Component Unit, and Pension Plans

Condition

Each year, the City Controller requests copies of the audited financial statements and certain schedules from the City's proprietary funds, component unit, and pension plans to be submitted by mid-November. However, during the June 30, 2003 reporting year, we noted that the enterprise departments, component unit, and pension plans were non-responsive to the City's financial reporting deadline. The audited financial statements and related schedules of the proprietary funds, component unit, and pension plans were provided to the Controller's Office in late December, causing the delay in the issuance of the City's Comprehensive Annual Financial Report (CAFR). In order to be considered timely, current reporting standards require that annual financial statements should be issued within six months of the close of the fiscal year. The City's CAFR for the fiscal year ended June 30, 2003 was issued on January 20, 2004.

Recommendation

We recommend City management to effectively communicate to the aforementioned entities' management, the importance of the timely submission of the entities' audited financial statements to the City Controller. The City, as a whole, has the fiduciary responsibility to report to its stakeholders, in a timely manner, its financial condition and results of operations.

We also encourage the Mayor, the Controller, and the City Council to take appropriate measures to ensure the aforementioned entities' compliance with the City's financial reporting requirements.

Current Year Status

The financial issues facing the City make the issuance of the City's CAFR by December 31, 2009 impossible. The City has been aggressively attempting to manage its financial difficulties, but in doing so has created a situation in which key financial and other important positions are kept vacant. In addition, the City has taken steps to bring the City's expenditures in line with revenue through staff reduction. The process for preparing and auditing CAFR has been delayed as it is competing with reduced staffing and other priorities throughout the City. As a result, the issuance of the City's CAFR was delayed.

The City's CAFR for the fiscal year ended June 30, 2009 was dated January 29, 2010, except for Note 5F to the Basic Financial Statements as to which the date is February 17, 2010, and submitted to the Government Finance Officers Association (GFOA) on February 26, 2010.